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C O N F I D E N T I A L MOSCOW 003367

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TAGS: [ECON](#) [EFIN](#) [EINV](#) [EAGR](#) [RS](#)
SUBJECT: GOR EFFORTS TO AID RETAIL SECTOR RAISES QUESTIONS

REF: MOSCOW 3151

Classified By: Minister Counselor Eric T. Schultz for reasons 1.4 (b, d)
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Summary

¶1. (C) As Russia's financial crisis gathered steam in recent weeks and began to spill over into the real economy, the GOR identified food retailers as a critical sector that the state should support. Industry insiders attributed the inclusion of the sector to a desire to support Russian agriculture and keep shelves stocked. The GOR subsequently extended a few credit lines. These credits, however, largely went to well-connected companies and have since stopped, without any explanation from the government. One of the firms with whom we talked suggested that with or without government support, it sees opportunities in the sector for low-cost retailers.
End Summary

Government Largesse to a Favored Few

¶2. (SBU) Last month, the GOR publicly identified retail, construction, and banking as &critical8 sectors of the economy that it intended to support. In the retail sector, the government specifically identified food retailers as companies that would receive government support in the form of inexpensive credit. Industry insiders told us that supporting Russian agriculture and avoiding the potentially disruptive specter of empty shelves was the explanation for the Kremlin's decision. In that regard, First Deputy Prime Minister Viktor Zubkov stated that, "we have to prevent failures on the foodstuffs market, as any failure means increased consumer demand and tension in society."

¶3. (SBU) Following this announcement, retail outlets Magnit and Sedmoi Kontinent each reportedly received RUR 2.5 billion (USD 91 million) credit lines. Both companies are well-connected. Magnit CEO Sergei Galitskiy, who owns over 44 percent of the company, is an oligarch with close Kremlin ties. He was on the Forbes list of Russian billionaire in ¶2007. Sedmoi Kontinent is controlled by another politically connected individual, Alexander Zanadvorov, the former head of Sobinbank. Zanadvorov reportedly faced a Deutsche Bank margin call on 11 November for a USD 1 billion loan, collateralized by his Sedmoi Kontinent shares, and desperately needed the government credit to stay afloat.

14. (SBU) Having dispensed funds to a favored few retailers, however, the GOR then shifted course. The most recent list of "priority sectors" (publicized on 10 November), excludes the retail sector and no further credits have been extended. Deputy Minister of Industry and Trade Stanislav Naumov was reported to have said that this was because issues in the sector had "already been resolved". However, CEO Lev Hasis of X5, Russia's leading food retailer and part of Mikhail Fridman's Kremlin-connected Alfa Group, publicly disagreed and expressed the hope that retail would be included in the next package of measures. Shortly thereafter, X5 received a RUR 5 billion (USD 182 million) loan from the government.

But Others Still See Opportunity

15. (C) Fedor Ribasov, Vice President of Dixy Group, another leading Russian food retailer complained to us that the government loans were only going to those with connections, which did not include his company. Ribasov was reluctant to divulge details about Dixy's discussions with Sberbank and VTB over a loan but did say that the interest rate they had been offering Dixy was exorbitant, 14-18%, and that the bank was looking for property as a pledge. Since Dixy had had no property that could be used as collateral, it had been unable to complete a loan package. Ribasov said Dixy was nonetheless in good financial shape and would survive the crisis, which he predicted would last through 2009, without government aid. Expansion plans would have to be put on hold, but this was not critical to the long-term health of the company.

16. (C) Ribasov told us that the crisis would also "provide opportunities" to retailers, especially low-cost retailers like Dixy. As Russians' budgets tightened, they would need to adjust their consumption habits "downward" creating more demand for the discount product Dixy sells. Upscale firms like Sedmoi Kontinent would suffer despite their access to government loans. The credit crunch would result in consolidation in the sector, providing takeover opportunities for Dixy and similar firms. For example, he said, Lenta (in which both Walmart and Carrefour have shown interest) is struggling already and may well get taken over.

Comment

17. (C) The GOR's economic rescue efforts are being undermined by a lack of transparency and a perception that funds are flowing to well-connected individuals and companies, rather than those truly deserving of support. Corruption is a major factor impeding efficient financial intermediation in Russia at the best of times. It is likely to prove the main stumbling block to GOR efforts to mitigate the economic effects of the financial crisis, ensuring that the downturn will be both deeper and longer than necessary.
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